“Can breaking ground build an economy?”

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3 African infrastructure investment opportunities and sustainable development

SUMMARY: Africa is a challenging investment environment. Our expertise at Investec Asset Management enables us to navigate its diverse and complex economies to become an established investor through the capital structure. The infrastructure investments we make through our Africa Private Markets strategies show how long-term asset owners can contribute to sustainable development, while generating investment returns. In this article we discuss how the demand for long-term funding creates opportunities for public-private partnerships in Africa. We also detail our recent investment in a bond issued by telecoms company, IHS Towers Nigeria. Investments such as these act not only as a developmental multiplier, they also strengthen African capital markets, facilitating further investment partnerships.

Growing pressure on financing in African markets

African markets have gone through a challenging period between 2012 and 2016, marked by less accommodative US monetary policy, negative sentiment towards emerging markets and the fallout from the sharp plunge in commodity prices. Investor sentiment towards emerging markets has improved over the last few months and many commodity prices have enjoyed a bounce. While the fundamental structural drivers of economic growth on the continent are still intact, lack of funding, especially in the infrastructure space remains a challenge.

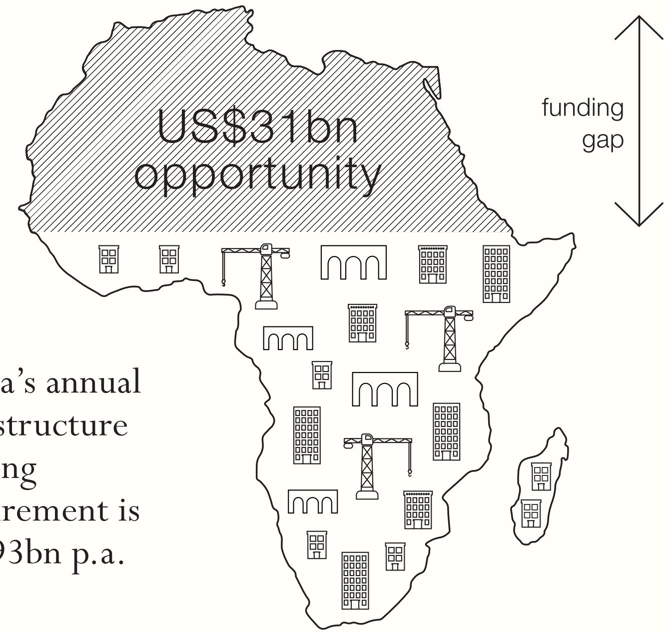
The fall in commodity prices and the subsequent slowdown in economic growth in Africa have put pressure on both government and international private sector financing. After steadily increasing direct investment in Africa since 2000, Chinese entities have sharply reduced the number of new projects since 2013. In addition, commercial banks have withdrawn funding due to worries about the Africa growth outlook and Basel III requirements. Government finances are constrained and rising bond yields have pushed up Africa's borrowing costs significantly since 2014.

Private-public partnerships gaining traction

Africa still requires at least US$93 billion in infrastructure investment per annum, with an estimated infrastructure funding gap of some US$31 billion per annum according to the Brookings Institution[1]. The slowdown in economic growth has had a bigger impact on the supply of capital than on potential ventures on the continent. Many projects have been shelved. But given the lack of facilities in many countries, there are still viable projects and opportunities for business expansion. This is particularly true in the infrastructure space. However, even within the broader economies, there is a huge lack of shopping facilities, schools and accessible financial services.

We believe it is an ideal opportunity for private-public partnerships (PPPs) to provide long-term funding for African infrastructure. This should boost long-term potential growth on the continent. We are starting to see PPPs gaining traction. Investec Asset Management is currently responsible

[1] https://www.brookings.edu/blog/up-front/2013/10/09/financing-africas-infrastructure-gap/



Africa's annual infrastructure funding requirement is US$93bn p.a.

for US$1.2 billion invested in African infrastructure as at May 2017. Of this, US$670 million is through the Emerging Africa Infrastructure Fund (EAIF), which is managed by Investec Asset Management. The remainder is through the Investec Credit Opportunities and Africa Credit Opportunities funds. The funding comprises both project finance and corporate finance debt. The Credit Opportunities portfolios have 21 investments across Africa. The EAIF is currently funding 42 projects across Africa, all of which are run by the private sector. The bulk of them rely on offtake agreements from the public sector.

One of the most successful countries in this space is Uganda, where the GET FiT programme has provided a template for renewable PPPs. Senegal and Mali have also successfully used PPPs. For example, the EAIF has helped to finance the Tobene power plant in Senegal. The 96MW power station provides electricity to 1.5 million Senegalese. Boosting energy generation in Mali is also enjoying top priority, with the government making use of PPPs in the power sector.

What is heartening is that we are seeing projects being developed in previously neglected countries. The government of Benin has identified 45 key infrastructure projects, worth US$15 billion, that it hopes to roll out over the next five years. The plan is for more than 60% of these projects to be financed through PPPs. Delays are almost inevitable, but even if a fraction of the planned projects come to market, this points to a big increase in required funding.

Strong demand for long-term funding

The African debt markets are much less developed than those of the large financial markets, such as the US. In particular, the corporate credit markets are still in their infancy. Therefore, private sector real estate developers, infrastructure sponsors and companies are much more dependent on either bank funding or private debt funding to grow. In the last three years, both the breadth and depth of the credit market have expanded significantly as the number and size of issuers have grown.

While there is some liquidity in sovereign debt markets, this has fallen significantly in recent years. The private credit markets, which include infrastructure, are by definition illiquid. However, investors in these areas are well aware of the constraints and benefits of these investments.

In our view, insurance and pension funds need to develop asset-liability management strategies that require good quality debt instruments with long maturities to boost debt investment in the infrastructure asset class. Currently, infrastructure projects in Africa are more likely to be funded by development finance institutions (for example, the EAIF, International Finance Corporation, World Bank, African Development Bank and Islamic Development Bank) than by commercial banks and pension and insurance funds. In developed markets, the private sector institutions provide the bulk of debt funding for such projects. Infrastructure projects need long-term investors who can stay invested, typically for 15 to 20 years. Because commercial banks have a much shorter investment horizon, there are limitations to the funding they can provide for infrastructure.

Pension funds in Africa are still relatively small. The four countries with reasonably sized pension funds are Namibia, Botswana, Nigeria and Kenya. Namibia and Botswana are trying to channel their funds into local infrastructure projects. However, the flow of projects in both has been slow.

Projects have been more plentiful in Nigeria and Kenya. In those countries, pension funds are relatively new and are therefore risk averse. They desire liquidity – which infrastructure investing does not offer.

At the same time, developed market pension and insurance funds are hesitant to invest in sub-investment grade African infrastructure debt due to their perceptions around risk. Alleviating concerns around these perceived risks is key to attracting both developed market and local African pension fund money into infrastructure funding for projects on the continent.

Investec support of IHS Towers Nigeria bond issue

With deep roots in Africa, Investec Asset Management is playing a key role in reducing the infrastructure funding gap, and helping to meet development goals with infrastructural multipliers, such as telecommunications. Our investments in telecoms company, IHS Towers Nigeria, through our African Credit Opportunities Fund (ACO) and the US$670 million fund we manage on behalf of the Emerging Africa Infrastructure Fund (EAIF), demonstrate our conviction. The EAIF is the largest facility that falls under the banner of the Private Infrastructure Development Group (PIDG), which has been a catalyst for infrastructure investment on the continent.

Positive development impact of the Emerging Africa Infrastructure Fund

The EAIF is contributing to meeting the UN SDGs by 2020 to support developing countries. It is an example of how financial actors can make a contribution to long-term sustainability and development as outlined by the BSDC. The EAIF ensures that all projects it finances comply with both the relevant national legislation and with international best practice, as set out in the International Finance Corporation’s (IFC) Performance Standards on Social and Environmental Sustainability and the supporting environmental, health and safety guidelines.

The EAIF projects are subject to rigorous due diligence processes and assessed against a number of cumulative and annual development targets. This includes the number of people who receive improved quality of services, and the magnitude of private sector investment that is mobilised, particularly in fragile countries. According to the EAIF, for every US dollar it has committed, a further US$15.3 has been committed by the private sector. For every million dollars committed by the EAIF, it is estimated that 139,138 people will have either gained services, or have an improved quality of services. The EAIF has also remained committed to its fragile states and OECD Development Assistance Committee targets.

Evaluation of investment in the IHS Towers Nigeria bond issue

IHS Towers is the largest independent telecommunications tower infrastructure company in Africa, leasing tower space for communications equipment to mobile network operators as well as providing opportunities to new market entrants and bespoke construction of new towers. Both the EAIF and ACO have participated in four rounds of financing with IHS Towers Nigeria. Investec Asset Management was also an early investor in IHS Towers Nigeria equity through our Africa Private Equity strategy. Our most recent investment in IHS Towers Nigeria, in its US$800million inaugural October 2016 Nigerian bond issuance, was made in difficult market conditions. EAIF was the much needed joint-anchor investor alongside the IFC.

The recent IHS Towers Nigeria bond issue was a five-year, senior, unsecured, high-yield issue with a coupon rate of 9.5%. The nearly US$1 billion bond issue was large for the Nigerian market, and particularly significant because it represented the largest single-tranche bond of any Nigerian entity, the largest ever US-dollar denominated high-yield deal in Africa, and the first indigenous Nigerian instrument with an issue rated higher than the sovereign.

We believe this benchmark-setting issuance broadens African debt capital markets, paving the way for other corporate issuers to follow. For example, Helios Towers (a telecoms tower company in Africa) decided to follow IHS by issuing a similar bond in March 2017. Helios Towers would not have taken such a step if the IHS issue had not been a success. In addition, the IHS bond issuance facilitated a more liquid asset class for investors. Though it is unsecured, it pays an attractive coupon rate compared to conventional, secured commercial loans, which are also more illiquid. Further, as senior bondholders, we have sought to mitigate risk with measures such as negative covenant pledges. Investors in Nigerian assets face macroeconomic headwinds including foreign exchange constraints and a volatile naira.

The quality of investments in such markets is therefore key. In the case of IHS Towers Nigeria, several metrics recommend it: a significant portion of its income is US-dollar denominated, and its revenue base is stable. The bond issue will allow IHS Towers Nigeria to continue to expand its network and tower services throughout Nigeria. With our business having started in Africa, we are particularly pleased to have been instrumental in the success of this bond issue.

As joint-anchor investor, our mandate for the EAIF played a key role in stimulating awareness and confidence in the bond issue and demonstrating international appetite for investing in strong African businesses. Participating in this bond issuance has also given us the opportunity to contribute to the development of Nigeria's telecommunications infrastructure, which in turn is central to stimulating the wider Nigerian economy.

Through effective structuring and collaboration in this successful project, the EAIF is contributing to capital market development, while closing the funding gap in African infrastructure, and at the same time generating an attractive yield. The project's developmental impact also extends to job creation, and makes the roll out of telecommunications services, broadband and 4G more cost efficient, and therefore more affordable for Africans.

Our engagement in IHS Towers demonstrates that, while investing in Africa can be challenging, our substantial experience in African public equity, private equity, credit and emerging market debt makes us well-placed to identify and manage investment opportunities. Such investments are also demonstrative of how both economic development and private sector commercial imperatives can be addressed with thorough research and canny allocations.